

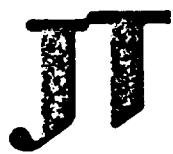
June 1989

*Shigeru Mizuno*

Shigeru Mizuno  
President and Chief Executive Officer

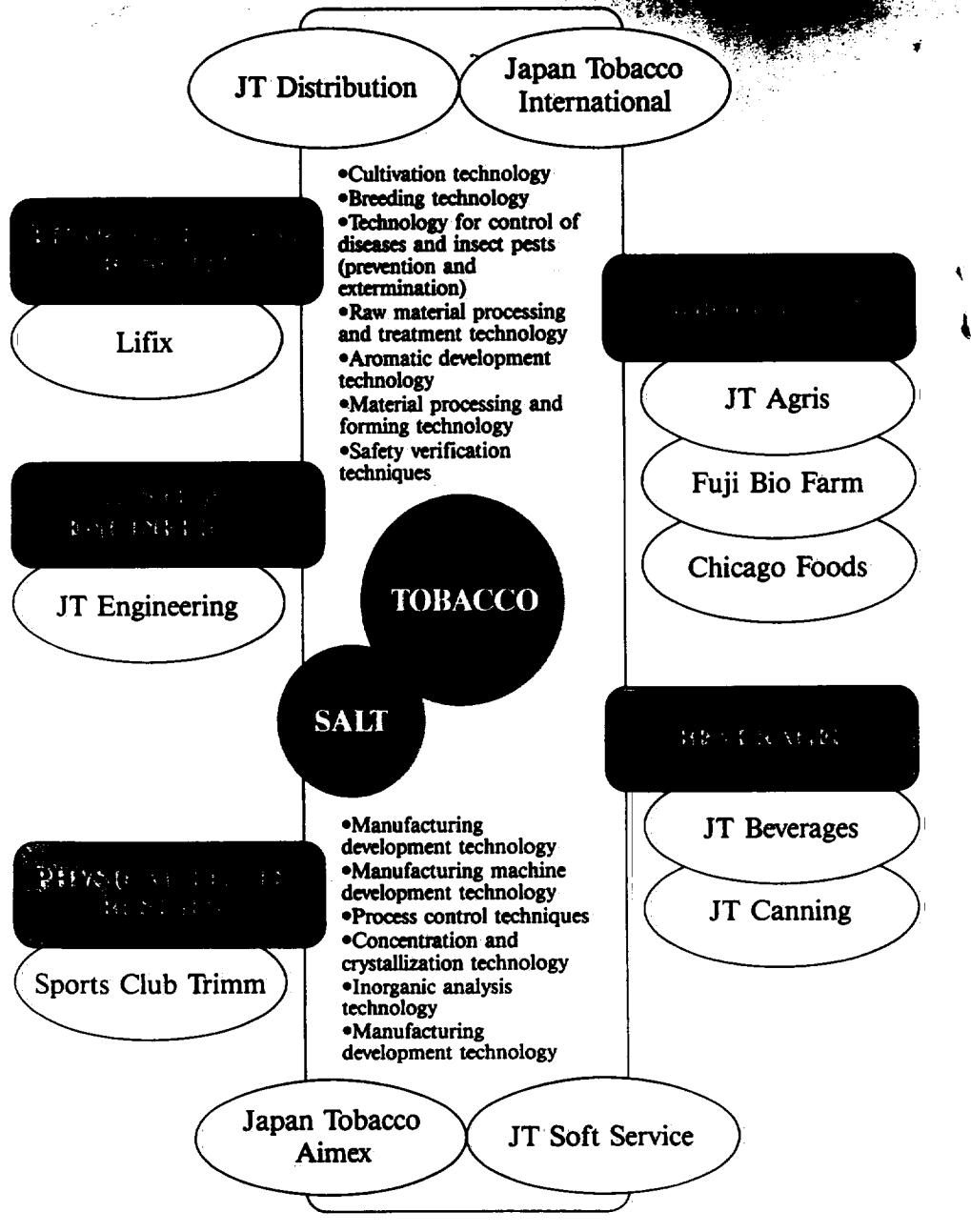
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FOR THE YEAR ENDED MARCH 31, 1989



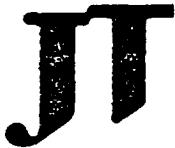
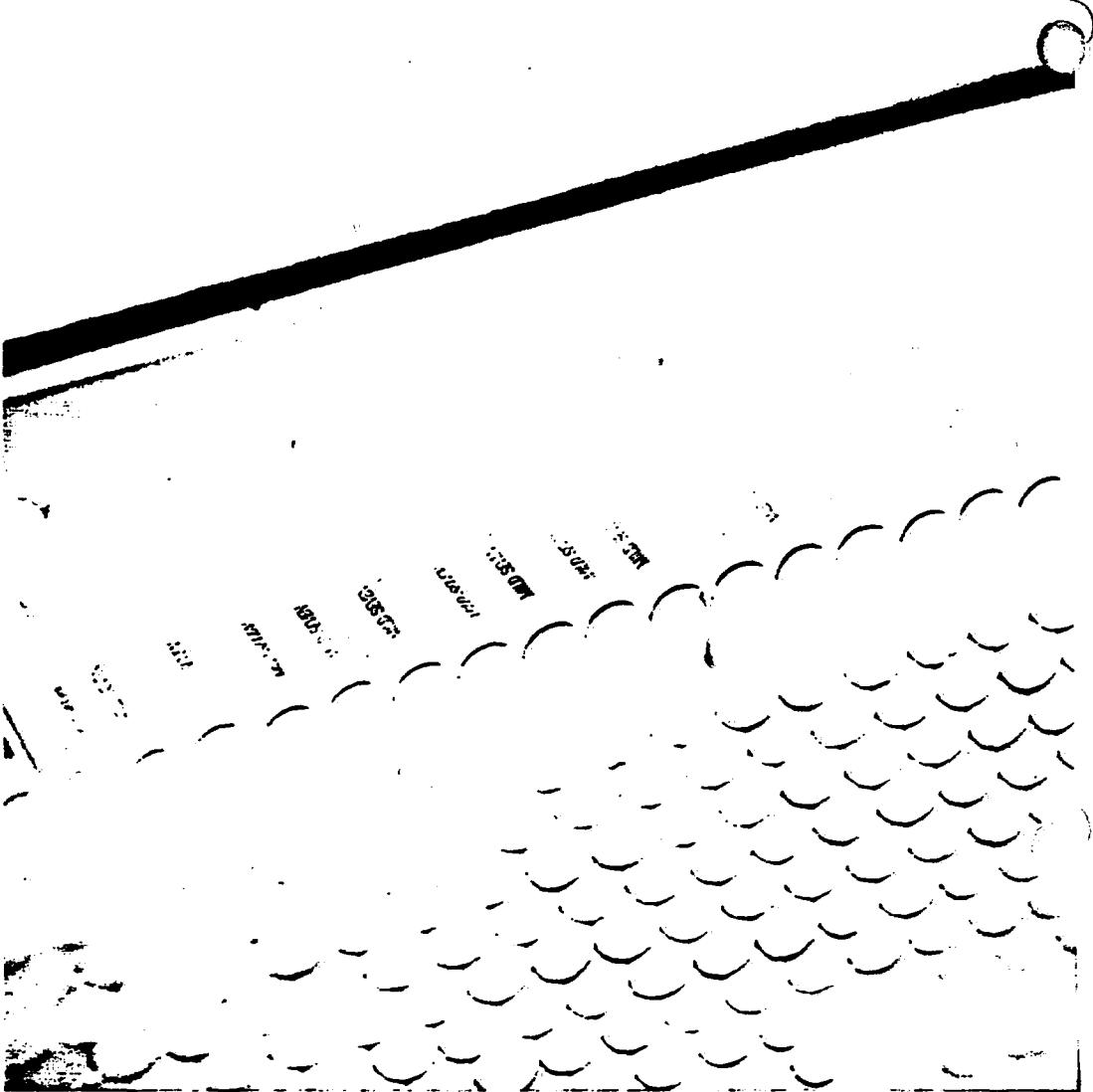
JAPAN TOBACCO INC. ANNUAL REPORT 1989

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*The MILD SEVEN family, a major Japan Tobacco brand group, accounts for 46.7% of all cigarettes sold by the Company in the domestic market, while MILD SEVEN accounts for 55.0% of all cigarettes exported, indicating its recent growth as a global brand.*



## TURNING OVER A NEW LEAF

From its early years as Japan Tobacco and Salt Public Corporation, the promotion of brand recognition has been a crucial part of the Company's marketing strategy for tobacco products. For example, one of its earliest cigarette brands, Peace, drew wide attention after the Company engaged an internationally recognized designer to redesign its package. In recent years, we have continued developing and promoting new brands while expanding existing brands for the domestic market. At present, there are more than 70 Japan Tobacco cigarette

brands on the market, and the Company's main brand, MILD SEVEN, now accounts for 26.0% of the Japanese market for cigarettes. Our other main brands, CASTER and CABIN, are also well known, with the number of smoking devotees increasing every year. These and other leading brand-name products represent one more aspect of our asset wealth.

In recent years, changes in market demand have led Japan Tobacco to review its future strategy. Therefore, we have shifted our energies toward

*Through the AFFINIS ARTS FOUNDATION, Japan Tobacco supports music performances. In 1989, the foundation's activities included the sponsorship of concerts and training sessions for musicians.*



## HELPING PEOPLE GROW

Japan Tobacco's most important corporate objectives are to serve the community and to make the world a better place to live. We have a long history of serving the public through the promotion of cultural activities and environmental campaigns, among other programs.

The Tobacco and Salt Museum, located in central Tokyo, first opened its doors to the public in 1978. Since then, many visitors have learned about the history and important uses of tobacco and salt in our lives through exhibits, mini-lectures, and field trips. This unique

museum has more than 22,000 items on permanent display through which the public can visualize the history of tobacco and salt. In addition, several special exhibits are held annually, covering topics of interest for the public.

Another method of fulfilling our responsibilities as a corporate citizen has been our "Smokin' Clean" campaign. Since 1963, we have endeavored to inform the Japanese public about the importance of keeping our living environment clean, and we have cooperated with fire safety officials to keep the

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	Millions of yen		Millions of U.S. dollars
	1988	1989	1989
<b>LIABILITIES AND SHAREHOLDER'S EQUITY</b>			
<b>Current liabilities:</b>			
Short-term bank loans	¥ 56,000	¥ 61,000	\$ 462
Current portion of long-term debt	140	228	2
Excise taxes payable	158,352	150,097	1,137
Trade payables	44,773	49,627	376
Income taxes payable	55,756	15,041	114
Accrued employee bonuses	10,073	9,181	69
Other current liabilities	1,557	5,185	39
Total current liabilities	326,651	290,359	2,199
<b>Non-current liabilities:</b>			
Long-term debt	16,374	16,632	126
Liability for severance payments	186,318	181,194	1,373
Other non-current liabilities	7,161	800	6
	209,853	198,626	1,505
<b>Commitments and contingencies</b>			
<b>Shareholder's equity:</b>			
Common stock, ¥50,000 par value;			
Authorized—8,000,000 shares			
Issued and outstanding—2,000,000 shares	100,000	100,000	758
Additional paid-in capital	736,400	736,400	5,579
Legal reserve	1,600	2,400	18
Retained earnings	72,811	95,210	721
Total shareholder's equity	910,811	934,010	7,076
	<u>¥1,447,315</u>	<u>¥1,422,995</u>	<u>\$10,780</u>

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JAPAN TOBACCO INC.

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# NON-CONSOLIDATED BALANCE SHEETS

Japan Tobacco Inc.  
Years ended March 31, 1988 and 1989

	Millions of yen		Millions of U.S. dollars (Note 3)
	1988	1989	1989
<b>ASSETS</b>			
<b>Current assets:</b>			
Cash	¥ 75,661	¥ 80,454	\$ 610
Short-term investments, mainly time deposits and certificates of deposit	91,365	141,286	1,070
Trade notes and accounts receivable	12,117	14,397	109
Inventories (Notes 4 and 6)	854,148	769,235	5,828
Other current assets	<u>10,185</u>	<u>16,309</u>	<u>123</u>
Total current assets	<u>1,043,476</u>	<u>1,021,681</u>	<u>7,740</u>
<b>Property, plant and equipment:</b>			
Land	106,297	107,489	815
Buildings and structures	378,155	387,844	2,938
Machinery and equipment	318,275	322,096	2,440
Vehicles and tools	26,049	30,755	233
Construction in progress	<u>6,381</u>	<u>2,934</u>	<u>22</u>
	<u>835,157</u>	<u>851,118</u>	<u>6,448</u>
Less accumulated depreciation	<u>413,972</u>	<u>430,031</u>	<u>3,258</u>
	<u>421,185</u>	<u>421,087</u>	<u>3,190</u>
<b>Investments and other assets:</b>			
Investments in subsidiaries and associated companies	5,235	8,498	64
Investment securities	22,975	26,095	198
Other assets	<u>25,173</u>	<u>24,105</u>	<u>183</u>
	<u>53,383</u>	<u>58,698</u>	<u>445</u>
	<u>¥1,518,044</u>	<u>¥1,501,466</u>	<u>\$11,375</u>

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Overseas points of operations, such as Hong Kong, provide us with a springboard from which we can penetrate and expand our overseas business while serving as a constant monitor for changes in overseas markets.

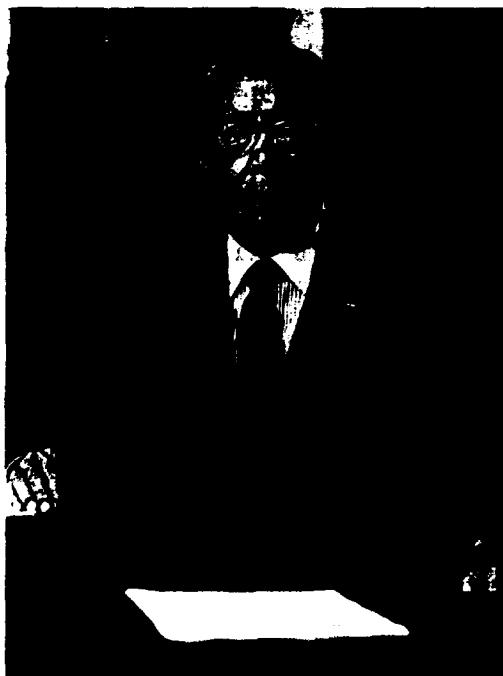
over the previous year, and in fiscal 1989, exports rose an additional 62.0%.

MILD SEVEN represented 55.0% of total cigarette exports in fiscal 1989. This clearly indicates that MILD SEVEN is already a global brand.

The Company attributes its success to a growing recognition of its product quality throughout the world. For those markets to which export is nearly

impossible, such as the European Community, local production under license is being used and will continue to be implemented where necessary as a positive alternative to further the successful sale of our products in the future.

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Kazuo Iwata



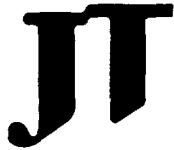
Shigeru Mizuno



Yasushi Endo



Kinya Katsukawa



## DIRECTORS AND OFFICERS

### Chairman of the Board

Kazuo Iwata

### President and Chief Executive Officer

Shigeru Mizuno

### Senior Executive Vice Presidents

Yasushi Endo

Kinya Katsukawa

### Executive Vice Presidents

Tsutomu Kamiwaki  
*Manufacturing, Machinery Enterprise*

Tomoyuki Sato  
*Leaf Tobacco*

### Executive Directors

Kiyotane Edayoshi  
*Salt Administration*

Yutaka Wakushima  
*Marketing*

Hideo Murayama  
*Pharmaceutical Business*

Tatsuro Suzuki  
*Business Development  
and Affiliated Business; Beverage,  
Real Estate, Physical Distribution;  
Internal Audit*

Kunio Kato  
*Fundamental Research,  
System Engineering*

Jiro Sekiguchi  
*Public Relations, Personnel*

Kazuya Niinomi  
*Domestic Leaf Tobacco*

### Corporate Counselor, Director

Tadayuki Ishii

### Managing Directors

Hitoshi Oki  
*Kanto Regional Sales Headquarters*

Hiroshi Goto  
*Planning, Finance, General Administration*

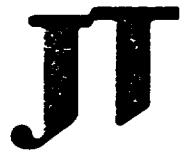
Toshio Kikuma  
*Labor Relations*

Nobuhiko Sagawa  
*Kansai Regional Sales Headquarters*

Yukiteru Obi  
*General Manager of  
Applied Plant Research Laboratory*

Tsutomu Eguchi  
*Manufacturing Information System*

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## SOWING THE SEEDS OF FUTURE HARVESTS

features. To develop these products, TSRL is also engaged in the development of technologies for vulcanization, swelling, and formulation of raw materials. In addition to application research, TSRL is responsible for new technological discoveries that will sow the seeds for basic, general research with a view to the long term.

Research at TSRL is divided into five areas: taste and fragrance, materials, smoke, analysis, and backup systems. In taste and fragrance, for example, TSRL is looking to develop a more

Through more than 85 years of R&D activities in the tobacco industry, Japan Tobacco has kept ahead of new developments and more recently entered into new areas of business. In April 1988, we reorganized our R&D operations to obtain closer links with each operational division. At present, there are research centers at nine locations throughout Japan where specialists in each field work in teams. Of these centers, seven are directly linked to an operational division to facilitate rapid development of marketable products. The remaining two, the Tobacco Science Research Laboratory (TSRL) and the Life Science Research Laboratory (LSRL), are engaged in basic research with a view to developing new business areas for the long term.

### Tobacco Science Research Laboratory

TSRL was established to engage in research for the development of innovative tobacco products. By exploring new technologies, this laboratory aims mainly to increase product quality, reduce costs, and develop new products. To develop prototypes for innovative products, TSRL is engaged in the development of new materials that can be used to gear products toward new trends and smoking tastes. Examples of such products include smokeless cigarettes, low-smoke-producing cigarettes, and cigarettes with built-in extinguishing



pleasant, mellow taste through the analysis of leaf tobacco. This involves examination of the composition of various aromas and substances in natural leaf tobacco, the development of liquid carbon dioxide and supercritical fluid-

extraction technology, and research into the metabolic functions of microbes through fermentation to find ways to enhance the taste and fragrance of tobacco.

Future success in the tobacco industry lies in this kind of basic, ground-breaking research. Through these research activities, Japan Tobacco, as a leading Japanese company, aims to further contribute to the growth of the tobacco industry and the Japanese economy.

2021391794

**PROFIT-ORIENTED OPERATIONS**  
**FINANCIAL POSITION**  
**March 31, 1988 and 1989**

	Millions of yen		Millions of U.S. dollars
	1988	1989	1989
<b>ASSETS</b>			
<b>Current assets:</b>			
Cash	¥ 74,780	¥ 79,427	\$ 602
Short-term investments, mainly time deposits and certificates of deposit	52,277	95,247	721
Trade notes and accounts receivable	3,006	5,050	38
Inventories	850,591	766,172	5,805
Other current assets	10,126	15,591	118
Total current assets	990,780	961,487	7,284
<b>Property, plant and equipment:</b>			
Land	103,712	104,897	795
Buildings and structures	373,454	382,323	2,896
Machinery and equipment	318,241	321,989	2,439
Vehicles and tools	25,526	29,975	227
Construction in progress	6,381	2,934	22
	827,314	842,118	6,379
Less accumulated depreciation	412,013	427,064	3,235
	415,301	415,054	3,144
<b>Investments and other assets:</b>			
Investments in subsidiaries and associated companies	5,203	8,466	64
Investment securities	11,375	14,453	110
Other assets	24,656	23,535	178
	41,234	46,454	352
	¥1,447,315	¥1,422,995	\$10,780

2021391812



Tsutomu Kamiwaki



Tomoyuki Sato



Kiyotane Edayoshi



Yutaka Wakushima



Hideo Murayama



Tatsuro Suzuki



Kunio Kato



Jiro Sekiguchi



Kazuya Niinomi

**Yasuhiro Olee**  
*Agribusiness*

**Ryuichi Yamada**  
*Chubu Regional Sales Headquarters*

**Standing Auditors**  
Daisuke Ishibashi  
Kazuo Ishii

**Vice Presidents**

Katsuhiro Honda  
*Planning*

Nobumaro Kawashima  
*Technological Planning*

Ryusuke Itoi  
*Information System*

Keiji Takemoto  
*General Administration*

**Akio Niitsu**  
*Public Relations*

**Makoto Ebara**  
*Personnel*

**Susumu Yamaguchi**  
*Real Estate*

**Yasuhiro Kato**  
*Finance*

**Hideo Yamada**  
*Physical Distribution*

**Takashi Ozaki**  
*Internal Audit*

**Shigeru Ichinose**  
*Business Development & Affiliated Business*

**Masayoshi Sato**  
*Agribusiness*

**Masamichi Nishimoto**  
*Pharmaceutical Business*

**Takashi Okada**  
*System Engineering*

**Morihiko Sometani**  
*Marketing*

**Seiichi Murakami**  
*Product Planning*

**Hiroshi Yoshimura**  
*Machinery Enterprise*

**Tamotsu Uchida**  
*Mechanical Enterprise*

**Yasumasa Ito**  
*Printing Enterprise*

**Hideyuki Yanaka**  
*Purchasing*

**Yoichi Kitada**  
*Overseas Leaf Tobacco*

**Tetsuro Tamura**  
*Salt Administration*

(As of June 28, 1989)

2021391799



"Tsukuba-1" is a new strain of tobacco leaf, developed through a haploid process, that is resistant to a diversity of diseases. Years of accumulated experience in the development of newly improved tobacco strains are being applied in new businesses.



A major presence on racing tracks across the country is the CABIN Racing Team. Japan Tobacco also has a high profile in a wide variety of musical and sports events. These provide entertainment for spectators and work as a powerful marketing tool.

improving our tobacco operations in anticipation of future changes. In addition to our three fundamental policies of lowering costs, increasing efficiency, and developing market-sensitive products, we have begun to focus more on internationalizing our operations as we seek to become a flexible, high-quality, and cost-competitive producer.

Efforts to cut costs include restructuring the domestic leaf tobacco procurement system, introducing the latest and most sophisticated tobacco making and packing equipment available for the

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In reviewing our business results for the year ended March 31, 1989, I am pleased to report on the progress we have made in working to enhance Japan Tobacco's operations. During the year, we worked to strengthen our competitiveness in the tobacco industry while continuing to expand our new areas of business.

#### Our Business Development

Although the Japanese economy remained strong in fiscal 1989 with an increase in overall consumption, our main business, domestic tobacco production, continued to face the challenges posed by leveled-off consumer demand for tobacco products and strict competition from other tobacco manufacturing companies. By meeting these challenges head on with the timely introduction of new brands developed to meet changing consumer tastes, extensive advertising, and sales promotion efforts, we were able to maintain a total market share of 87.9%.

Our growth in tobacco exports continued throughout fiscal 1989, increasing 62.0% in volume.

In addition to our tobacco business, we continued to pursue a program of diversification into such fields as pharmaceuticals and agribusiness for long-term future development. To fully utilize our resources and advanced technologies, we completely reorganized our research

#### Future Outlook

We believe that the domestic market for tobacco products will pose further challenges in the future based on frequently changing consumer tastes and ever intense competition. We plan to meet these challenges by responding flexibly to market demand by introducing innovative and creative products designed to meet varied consumer tastes. To attain the highest level of net income possible, we will continue to strengthen our product lines, reduce production costs, and enhance our marketing strategies. We also plan to continue promoting our tobacco exports worldwide in the interest of developing a global tobacco business.

Our diversification program will continue to play a major role in our future development. Founded on the advanced technologies, extensive distribution channels, and marketing capabilities developed through our tobacco activities, these areas of diversification—including pharmaceuticals, agribusiness, beverage production, and engineering—have been developed to provide consumers with a vast array of products specifically designed to meet market needs. We are committed to the development of prescription drugs that will help restore health and meet consumer needs. With these commitments, we are confident that our operations will increasingly

### A MESSAGE FROM THE PRESIDENT

and development laboratories to best meet the needs of our new diversification programs. Also, we have initiated production and marketing of over-the-counter (OTC) drugs and of beverages through newly established companies. These efforts clearly illustrate the steady progress of our diversification program in fiscal 1989.

Although revenue contributions from our new businesses remain minor, our combined efforts in the tobacco and salt business helped us to achieve net sales of ¥2,723.9 billion (\$20.6 billion) and net income of ¥38.3 billion (\$290.0 million).

contribute to our growth.

Although our business environment does not allow us to be optimistic about the future, we believe that our accumulated experience of more than 90 years in the tobacco business will continue to provide a solid foundation from which future growth can be assured. In fiscal 1989 we took one more step toward strengthening that foundation, and we look forward to many more successful years to come.

## CORPORATE PROFILE

Japan Tobacco Inc. was originally established in 1898 as a government bureau to operate a monopoly in tobacco. In 1905, the Japanese government added salt to its operations, and in 1949, the bureau became Japan Tobacco and Salt Public Corporation. This corporation was Japan's sole producer of tobacco and salt products until April 1985, when it was privatized and reestablished as Japan Tobacco Inc., a joint stock company fully owned by the Japanese government. At present, the Company maintains its leading position in the domestic tobacco industry with an 87.9% market share while continuing to serve the public's needs for salt products. In terms of sales, Japan Tobacco is the fourth largest tobacco company in the world and also ranks as one of the companies in Japan with the highest turnover.

As one of Japan's largest companies with abundant financial, technical, and human resources at its disposal, Japan Tobacco is continuing to explore new business opportunities while strengthening its more recently acquired businesses. Main directions of growth where Japan Tobacco is aiming to carve a niche include pharmaceuticals, agribusiness, and engineering. These business areas, along with tobacco, are expected to form a new foundation for the Company in the 21st century and beyond.

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This is a photograph of molecular fusion. Japan Tobacco is already engaged in innovative R&D in biotechnology, which forms the technological basis for its agribusiness. At present, our scientists are concentrating on the development and application of major herbicides and nonpolluting agrochemicals.

this product, with a launch date targeted for 1994.

In April 1988, we established Lifix Inc. in a joint venture with Yoshitomi Pharmaceutical Industries, Ltd., a Japanese pharmaceutical company, to promote diversification into the OTC drug market. Lifix began marketing cold and stomach medicines and fever and cough suppressants in October 1988 and a medicinal drink in August 1988. These products are sold in nearly half of all domestic pharmacies and drugstores. Lifix's health drink, Royal Star, is being

#### Agribusiness

Agribusiness includes a diversity of integrated operations ranging from the supply of seedlings to foods. This area includes a seed business rooted in the latest biotechnology, plants for the living environment, and foods for an enriched life.

In the agricultural sector, our main objective is to contribute to the farming family through the supply of agricultural materials, such as seeds. Through its expertise accumulated over many years of research in the tobacco business and de-

distributed through our tobacco sales outlets, another example of utilizing our unique and extensive sales network.

In other health-related areas, Japan Tobacco is aiming to build a diversified business by taking a fresh perspective on the emerging and varied needs of its customers. Some examples of the Company's efforts include the supply of hospital food and the creation of "health boutiques," which are facilities incorporating a multitude of services in clinics, sports clubs, and pharmacies.

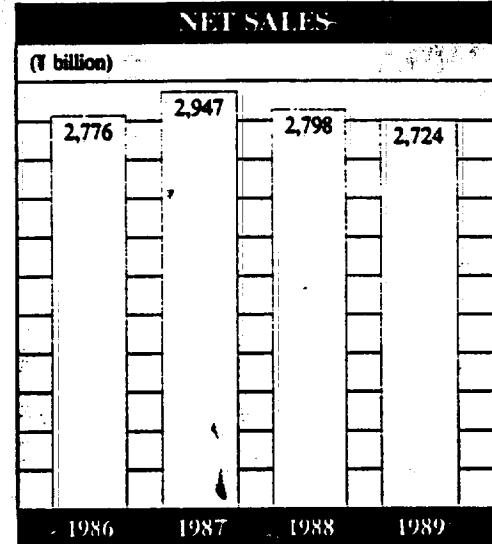
velopment of new tobacco varieties ahead of other companies in the industry, the Company has succeeded in applying its technologies in such fields as molecular fusion. At present, new types of flowers, vegetables, and cereals and grains are being developed mainly at the Plant Breeding and Genetics Research Laboratory and the Applied Plant Research Laboratory through the application of such technologies as genetic engineering and biotechnology. At the same time, we are aggressively working to develop fertilizers, herbicides, and

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# FINANCIAL SECTION

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In the year under review, the Company continued in its efforts to meet an increasingly challenging environment through the introduction of new products, promotional activities, and rationalization measures while strengthening its research and development.

### Tobacco Business Division

Although demand for most consumer products rose significantly to boost further growth in the Japanese economy, demand for tobacco products failed to show similar growth. While the market remained stagnant, competition became more intense as foreign tobacco companies sought to increase their market share via price cuts on the back of a strong yen and the reduction in the customs tariff to zero. These challenging conditions stimulated the Company into

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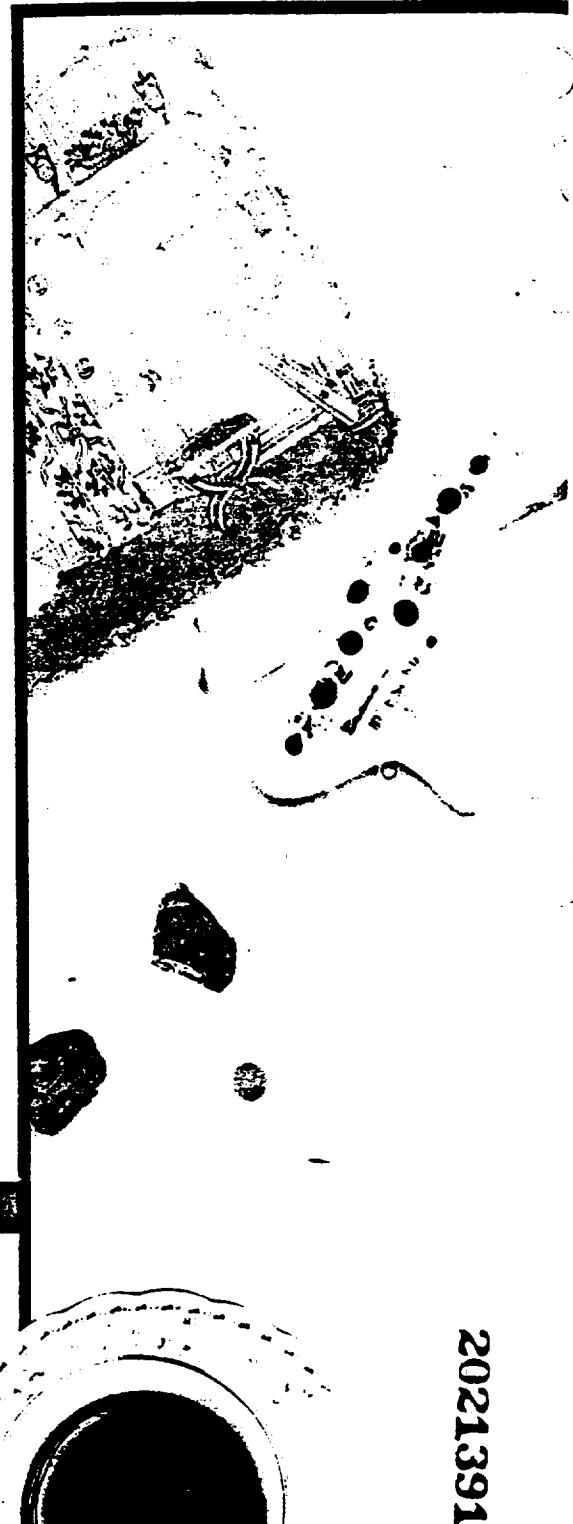
For nearly a century, Japan Tobacco has developed and honed its craft in the tobacco and salt industries. The Company is now recognized globally as an industry leader for its track record in research and technology in these industries. In Japan, we are regarded as a responsible and reliable corporate citizen, committed to the supply and development of quality products for our customers. While the Company remains obligated to serve the Japanese public as the sole agent and producer of salt products, gradual changes in government policy and rapid advances in technology have transformed its operating environment in tobacco. With privatization, Japan Tobacco is now in a better position to determine its own destiny by applying its accumulated technological expertise in areas outside of its present main areas of business.

Our roots lie in the tobacco and salt industries, but to meet and anticipate changes in our operating environment, we are seeking to expand our operations in both domestic and international markets. At present, we are continuing our diversification program into such areas as pharmaceuticals, agribusiness, and engineering. To better reflect these expanded operations, the Company elected to use "JT" as a communication logo in tandem with its corporate name, Japan Tobacco Inc.

Because our confidence to diversify



into new businesses originates from a rich history in the tobacco industry, we will continue to strengthen our tobacco business even as we seek to explore other avenues for growth in the future. This reflects our belief that strength in the tobacco industry will continue to play an important role in our future operations as we seek to better serve the needs of the community.



2021391781

# NON-CONSOLIDATED STATEMENTS OF SHAREHOLDER'S EQUITY

Japan Tobacco Inc.  
Years ended March 31, 1988 and 1989

	Millions of yen		Millions of U.S. dollars (Note 3)
	1988	1989	1989
<b>Common stock</b>	<b>¥100,000</b>	<b>¥100,000</b>	<b>\$ 758</b>
<b>Additional paid-in capital</b>	<b>¥736,400</b>	<b>¥736,400</b>	<b>\$5,579</b>
 <b>Legal reserve:</b>			
Balance at beginning of year	¥ 800	¥ 1,600	\$ 12
Add:			
Transfer from retained earnings	800	800	6
Balance at end of year	<u>¥ 1,600</u>	<u>¥ 2,400</u>	<u>\$ 18</u>
 <b>Capital funds of salt monopoly business</b>	<b>¥ 25,683</b>	<b>¥ 25,683</b>	<b>\$ 195</b>
 <b>Reserve for salt monopoly price stabilization:</b>			
Balance at beginning of year	¥ 30,407	¥ 39,690	\$ 301
Add:			
Transfer from retained earnings	9,283	7,060	53
Balance at end of year	<u>¥ 39,690</u>	<u>¥ 46,750</u>	<u>\$ 354</u>
 <b>Retained earnings:</b>			
Balance at beginning of year	¥ 54,050	¥ 72,811	\$ 552
Add:			
Net income	36,889	38,328	290
Deduct:			
Cash dividends, ¥4,000 per share	(8,000)	(8,000)	(61)
Bonuses to directors and statutory auditors	(45)	(69)	(1)
Transfer to legal reserve	(800)	(800)	(6)
Transfer to reserve for salt monopoly price stabilization	(9,283)	(7,060)	(53)
Balance at end of year	<u>¥ 72,811</u>	<u>¥ 95,210</u>	<u>\$ 721</u>

See notes to non-consolidated financial statements.

2021391807

	Millions of yen	Millions of U.S. dollars (Note 3)
	1988	1989
<b>LIABILITIES AND SHAREHOLDER'S EQUITY</b>		
<b>Current liabilities:</b>		
Short-term bank loans (Note 7)	¥ 56,000	¥ 61,000
Current portion of long-term debt (Note 7)	140	228
Excise taxes payable (Note 8)	158,352	150,097
Trade payables	46,847	52,311
Income taxes payable (Note 8)	55,757	15,042
Accrued employee bonuses	10,245	9,417
Other current liabilities	1,558	3,917
Total current liabilities	<u>328,899</u>	<u>292,012</u>
		<u>2,212</u>
<b>Non-current liabilities:</b>		
Long-term debt (Note 7)	16,374	16,632
Liability for severance payments	189,294	185,579
Other non-current liabilities	7,293	800
	<u>212,961</u>	<u>203,011</u>
		<u>1,538</u>
<b>Commitments and contingencies (Note 12)</b>		
<b>Shareholder's equity (Notes 9 and 13):</b>		
Common stock, ¥50,000 par value;		
Authorized—8,000,000 shares		
Issued and outstanding—2,000,000 shares	100,000	100,000
Capital fund of salt monopoly business	25,683	25,683
Additional paid-in capital	736,400	736,400
Legal reserve	1,600	2,400
Reserve for salt monopoly price stabilization	39,690	46,750
Retained earnings	72,811	95,210
Total shareholder's equity	<u>976,184</u>	<u>1,006,443</u>
	<u>¥1,518,044</u>	<u>\$11,375</u>

See notes to non-consolidated financial statements.

2021391805

**Japan Tobacco Inc.**  
**Years ended March 31, 1988 and 1989**

	Millions of yen	Millions of U.S. dollars	
	1988	1989	1989
<b>For the year:</b>			
Net sales	¥2,797,856	¥2,723,962	\$20,636
Net income	36,889	38,328	290
<b>At year-end:</b>			
Shareholder's equity	¥ 976,184	¥1,006,443	\$ 7,625
Total assets	1,518,044	1,501,466	11,375
<b>Amounts per share of common stock</b>			
(in yen and U.S. dollars):			
Net income	¥ 13,803	¥ 15,633	\$ 118
Cash dividends	4,000	5,000	38
Shareholder's equity	455,405	467,004	3,538

**Notes:** 1. Figures stated in U.S. dollars in this report are translated solely for convenience at the rate of ¥132 per US\$1 as of March 31, 1989.

2. The amounts for net income, cash dividends, and shareholder's equity per share are related to the profit-oriented operations.

- Through the development of new products and aggressive marketing, Japan Tobacco maintained its leading position in the Japanese tobacco industry with an 87.9% market share.
- Tobacco exports rose 62.0% year to year in volume.
- From April 1, 1988, Japan Tobacco's R&D activities were restructured to directly link each of the seven research arms with relevant operational divisions, and the Company also established two basic research organizations.
- Japan Tobacco continued to diversify its activities by establishing new companies, such as Lifix Inc., and by entering into such new business areas as the beverage industry.

## HIGHLIGHTS OF THE YEAR

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# NON-CONSOLIDATED STATEMENTS OF INCOME

Japan Tobacco Inc.  
Years ended March 31, 1988 and 1989

	Millions of yen		Millions of U.S. dollars (Note 3)
	1988	1989	1989
<b>Net sales</b>	<b>¥2,797,856</b>	<b>¥2,723,962</b>	<b>\$20,636</b>
<b>Cost of sales:</b>			
Cost of products sold	659,892	630,201	4,774
Excise taxes on products sold (Note 8)	1,793,452	1,735,411	13,147
	<u>2,453,344</u>	<u>2,365,612</u>	<u>17,921</u>
Gross profit	344,512	358,350	2,715
<b>Selling, general and administrative expenses</b>	<b>230,457</b>	<b>253,461</b>	<b>1,920</b>
Operating profit	114,055	104,889	795
<b>Other income (expenses):</b>			
Interest income, net	6,201	6,470	48
Loss on disposals of property, plant and equipment	(475)	(3,479)	(26)
Other, net (Note 11)	<u>2,407</u>	<u>(23,012)</u>	<u>(174)</u>
	<u>8,133</u>	<u>(20,021)</u>	<u>(152)</u>
<b>Income before income taxes</b>	<b>122,188</b>	<b>84,868</b>	<b>643</b>
<b>Income taxes (Note 8)</b>	<b>85,299</b>	<b>46,540</b>	<b>353</b>
<b>Net income</b>	<b>¥ 36,889</b>	<b>¥ 38,328</b>	<b>\$ 290</b>

See notes to non-consolidated financial statements.

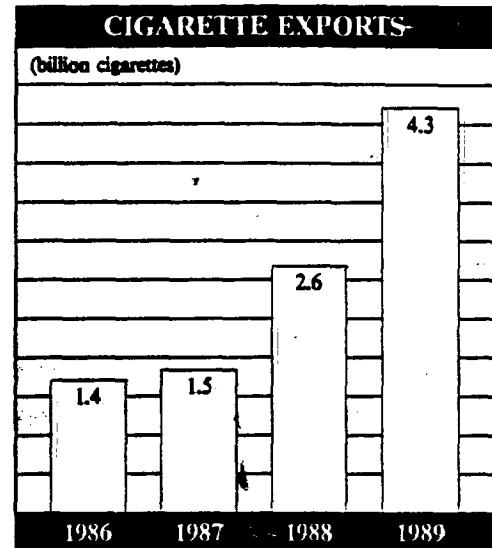
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its Tobacco Business Division or its Salt Business Division. However, the Company has been extremely pleased with the substantial growth many of its new business activities have shown in the year under review.

As a result of new brand introductions, increasing contributions from new operations, and vigorous promotional campaigns, total sales for the Tobacco Business Division in value only decreased 2.7%, to ¥2,654 billion, while tobacco sales volume decreased 3.2% from fiscal 1988, to 269.2 billion cigarettes, despite intense competition from foreign brands.

Lower national and regional taxes stemming from a decrease in tobacco sales volume contributed to lower cost of goods sold. In addition, the Company's efforts to rationalize production through the introduction of sophisticated equipment at its plants contributed to a 3.7% decline in cost of goods sold, to ¥88.2 billion, compared to fiscal 1988. However, substantial increases in promotional activities resulted in a 5.9% increase in selling, general and administrative expenses. This resulted in a 1.4% increase in operating profits, to ¥91.1 billion.

At the non-operating level, while income decreased ¥3.6 billion due to reduced interest income, expenses increased ¥550 million despite a decline in interest payments of ¥1.5 billion. This increase was mainly due to a rise of ¥2.9 billion in aid to leaf tobacco producers suffering from the negative effects of natural disasters. The result was a decrease of 3.0% in recurring profits, to ¥91.5 billion. Extraordinary losses of ¥19.6 billion stemming from a one-time payment to the Japan Leaf Tobacco Adjustment Fund resulted in a

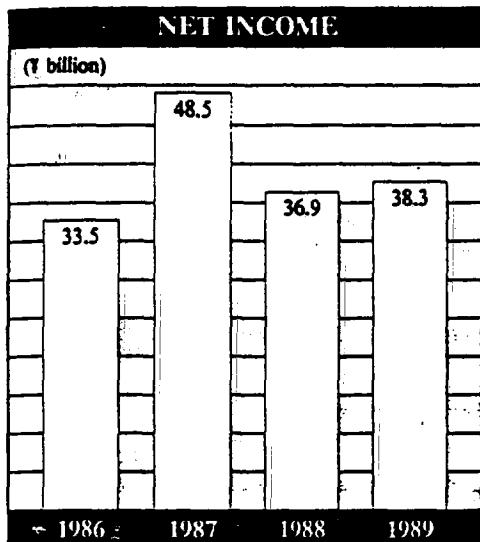


further decline in pre-tax income. However, with lower corporate and regional taxes, net income from tobacco operations increased 13.3%, to ¥31.3 billion.

#### Salt Business Division

In its role as the sole supplier of salt in Japan, the Company continued to ensure stability in supply and prices throughout fiscal 1989 while working to steer its salt business toward future independent operations as directed in January 1987 by the Salt Provisional Committee. Salt sales for common use remained unchanged from fiscal 1988, at 1.2 million tons, while sales from salt supplied to the caustic soda industry increased 6.6%, to 70.8 million tons, as industrial activity remained strong. However, due to a domestic salt price cut from fiscal 1987, total salt sales decreased

## MANAGEMENT REVIEW AND DISCUSSION



taking appropriate steps to meet present and possible future trends.

During fiscal 1989, the Company's best-selling tobacco brand, MILD SEVEN, continued to be the brand most favored by the Japanese public, with a 26.0% market share. The second most popular brand, MILD SEVEN Lights, had an estimated 14.7% market share. To maintain and further reinforce its image and dominant market position, the Company continued its program of carefully planned advertising and introduction of new products. New products introduced in the year under review include additions to the MILD SEVEN and CASTER families, MILD SEVEN FK, and CASTER MILD, in response to continued customer loyalty for these brands. In addition, SomeTime MIASS, an upmarket version of

the SomeTime LIGHT; Frontier, a super-low nicotine tar product; and CABIN 85 MILD Box, a hard-boxed package of CABIN 85 MILD, were introduced to customers. In addition, tobacco exports increased 62.0% in volume, to 4.3 billion cigarettes, due to sustained promotion of the Company's products in overseas markets by its subsidiary JATICO.

In fiscal 1989, the Company continued its diversification program by launching its beverage line, HalfTime; establishing JT Beverages to take charge of vending machine and other operations; and establishing Sports Club Trimm to promote health-related sports activities. On the international front, the production and export of vending machines and tobacco production machinery activities were continued. Other subsidiaries established in the year under review include Lifix, a joint venture company with a prominent Japanese pharmaceuticals company, and three other joint venture companies for the production and design of machinery and office equipment—JT CMK, JTS Denso, and JT Okamura. These three companies were all established with already available resources held by Japan Tobacco and represent another method of optimizing Company resources.

Since the Company's new business areas in agribusiness, pharmaceuticals, and engineering still represent only a tiny fraction of net sales, earnings contributions from these activities are shown together with tobacco sales in the Tobacco Business Division. While earnings contributions from new business areas remain insignificant relative to the Company's core business in tobacco, Japan Tobacco will continue its policy of dividing net sales into

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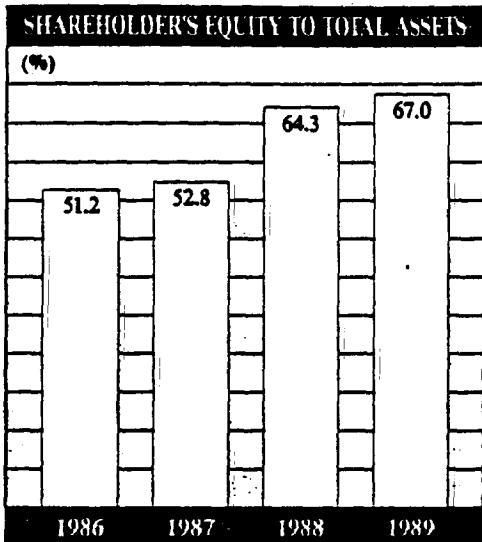
**PROFIT-ORIENTED OPERATIONS**  
**RESULTS OF OPERATIONS**  
Years ended March 31, 1988 and 1989

	Millions of yen	Millions of U.S. dollars	
	1988	1989	1989
<b>Net sales</b>	<b>¥2,727,151</b>	<b>¥2,654,025</b>	<b>\$20,106</b>
<b>Cost of sales:</b>			
Cost of products sold	611,532	581,408	4,404
Excise taxes on products sold	1,793,452	1,735,411	13,147
	<b>2,404,984</b>	<b>2,316,819</b>	<b>17,551</b>
<b>Gross profit</b>	<b>322,167</b>	<b>337,206</b>	<b>2,555</b>
<b>Selling, general and administrative expenses</b>	<b>215,268</b>	<b>236,816</b>	<b>1,794</b>
<b>Operating profit</b>	<b>106,899</b>	<b>100,390</b>	<b>761</b>
<b>Other income (expenses):</b>			
Interest income, net	4,128	4,039	30
Loss on disposals of property, plant and equipment	(473)	(3,460)	(26)
Other, net	2,332	(23,246)	(176)
	<b>5,987</b>	<b>(22,667)</b>	<b>(172)</b>
<b>Income before income taxes</b>	<b>112,886</b>	<b>77,723</b>	<b>589</b>
<b>Income taxes</b>	<b>85,280</b>	<b>46,455</b>	<b>352</b>
<b>Net income</b>	<b>¥ 27,606</b>	<b>¥ 31,268</b>	<b>\$ 237</b>

**PROFIT-ORIENTED OPERATIONS**  
**MOVEMENTS OF SHAREHOLDER'S EQUITY**  
Years ended March 31, 1988 and 1989

	Millions of yen	Millions of U.S. dollars	
	1988	1989	1989
<b>Common stock</b>	<b>¥100,000</b>	<b>¥100,000</b>	<b>\$ 758</b>
<b>Additional paid-in capital</b>	<b>¥736,400</b>	<b>¥736,400</b>	<b>\$5,579</b>
<b>Legal reserve:</b>			
Balance at beginning of year	¥ 800	¥ 1,600	\$ 12
Add:			
Transfer from retained earnings	800	800	6
Balance at end of year	<b>¥ 1,600</b>	<b>¥ 2,400</b>	<b>\$ 18</b>
<b>Retained earnings:</b>			
Balance at beginning of year	¥ 54,050	¥ 72,811	\$ 552
Add:			
Net income	27,606	31,268	237
Deduct:			
Cash dividends	(8,000)	(8,000)	(61)
Bonuses to directors and statutory auditors	(45)	(69)	(1)
Transfer to legal reserve	(800)	(800)	(6)
Balance at end of year	<b>¥ 72,811</b>	<b>¥ 95,210</b>	<b>\$ 721</b>

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1.1% in value from fiscal 1988, to Y69.9 billion. A change in some aspects of the salt procurement system resulted in a rise in cost of goods sold. Selling, general and administrative expenses also increased 3.0% with the contribution of Y1.5 billion to the Salt Science Foundation, resulting in a 37.1% decrease in operating income, to Y4.5 billion. Net income of Y7.1 billion was deposited in the reserve for salt monopoly price stabilization in accordance with the Monopoly in Salt Act.

#### Company Financial Position

Total assets decreased 1.1% compared to the previous year, to Y1,501.5 billion. Inventories of leaf tobacco, which comprise over half of total assets, continued to be reduced during the year. As a result of a decline in purchase prices and reduced inventory levels, leaf

tobacco stock decreased 9.9% compared to the previous year, to Y700.4 billion. Shareholder's equity, which is composed mainly of net income, increased Y30.3 billion. However, because capital expenditures were nearly equivalent to depreciation expenses, the increased amount was placed in time deposits and marketable securities for fund management. This increased short-term investments, mainly time deposits and certificates of deposit, 54.6% compared to the previous year, to Y141.3 billion. Current assets, which includes accounts receivable, decreased 2.1%, to Y1,021.7 billion. Because capital investment was held at last year's level, property, plant and equipment did not increase significantly in the year under review; however, investments and other assets showed a slight increase.

Due to reduced corporate taxes, deferred taxes decreased Y40.7 billion, and this contributed to the decline of Y36.9 billion in current liabilities. There were no significant changes in non-current liabilities.

As a result of these factors, working capital increased Y15.1 billion, and the liquidity ratio increased from 3.17 to 3.50. Shareholder's equity to total assets, reflecting increased retained earnings, continued to increase, rising from 64.3% to 67.0%. Net sales to total assets showed a minimal decrease from 1.84 to 1.81. As net income registered a moderate gain, total assets fell slightly.

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## 7. Short-term bank loans and long-term debt

Short-term bank loans of ¥61,000 million are represented by 90-180 day notes bearing interest at the rate of 3.375% per annum and are not secured.

Long-term debt comprised the following:

	Millions of U.S. dollars		
	1988	1989	1989
5% Swiss franc bonds due 1994	¥14,305	¥14,305	\$108
4.4% to 5.3% unsecured loans from banks due 1993-1996	2,005	2,177	17
Unsecured loans from Bio-Oriented Technology Research Advancement Institution	204	378	3
	16,514	16,860	128
Less current portion	140	228	2
	¥16,374	¥16,632	\$126

The obligations created by the bonds are secured by a statutory preferential right, according to the Law, over the whole property of the Company. Unsecured loans from the Bio-Oriented Technology Research Advancement Institution are repayable from March 1992 through September 2001 with interest at the weighted average rate of 4.75% per annum.

## 8. Income taxes and excise taxes

The Company is subject to a corporate tax, inhabitants taxes and enterprise taxes based upon income from the profit-oriented operations, which in the aggregate, resulted in a normal statutory rate of approximately 56%.

The salt operations are exempt from income taxes with certain exceptions. The effective tax rates in the statements of income differ from the normal statutory rate, primarily because of the effect of timing differences, the effect of permanently non-deductible expenses, the lower tax rate applied to the portion of income distributed as dividends, tax credit for research and development expenditures, and the tax exemption of the salt operations.

The Company is also subject to national and local excise taxes, comprised of an ad valorem duty and a specific duty, on the tobacco products.

Excise taxes included in the cost of sales for the years ended March 31, 1988 and 1989 were as follows:

	Millions of yen		Millions of U.S. dollars
	1988	1989	1989
National	¥ 901,375	¥ 872,467	\$ 6,610
Local	892,077	862,944	6,537
	¥1,793,452	¥1,735,411	\$13,147

## 9. Shareholder's equity

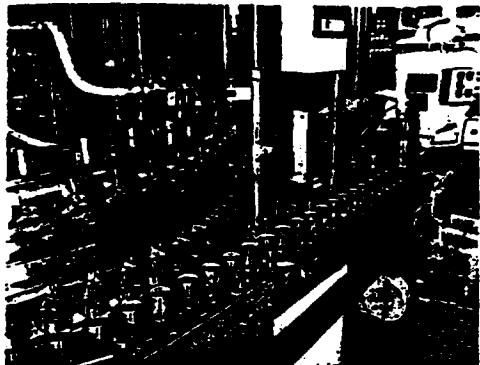
Shareholder's equity items of the Company comprised those of the profit-oriented operations and those of the salt operations in accordance with the Japanese Commercial Code and the Monopoly Act.

The capital fund of salt monopoly business and the reserve for monopoly price stabilization in accordance with the Monopoly Act are not necessarily of the same nature as those required by the Japanese Commercial Code, because they have been deemed funds for the salt operations. The Company is also subject to the Japanese Commercial Code with regard to the profit-oriented operations.

As regards the profit-oriented operations, the Japanese Commercial Code provides that a portion of retained earnings in an amount equal to at least 10% of cash dividends be appropriated as a legal reserve until such reserve equals 25% of the amount of common stock. This reserve is not available for dividends, but may be used to reduce a deficit by resolution of the shareholder or may be capitalized by resolution of the Board of Directors.

In accordance with the Japanese Commercial Code, the appropriations of retained earnings and bonuses to directors including cash dividends have been reflected in the financial statements in the period in which they are approved at the shareholder's meeting to be held in the following year.

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*Our HalfTime series of delicately flavored drinks, which was developed through the most advanced technology, is rapidly increasing in popularity.*

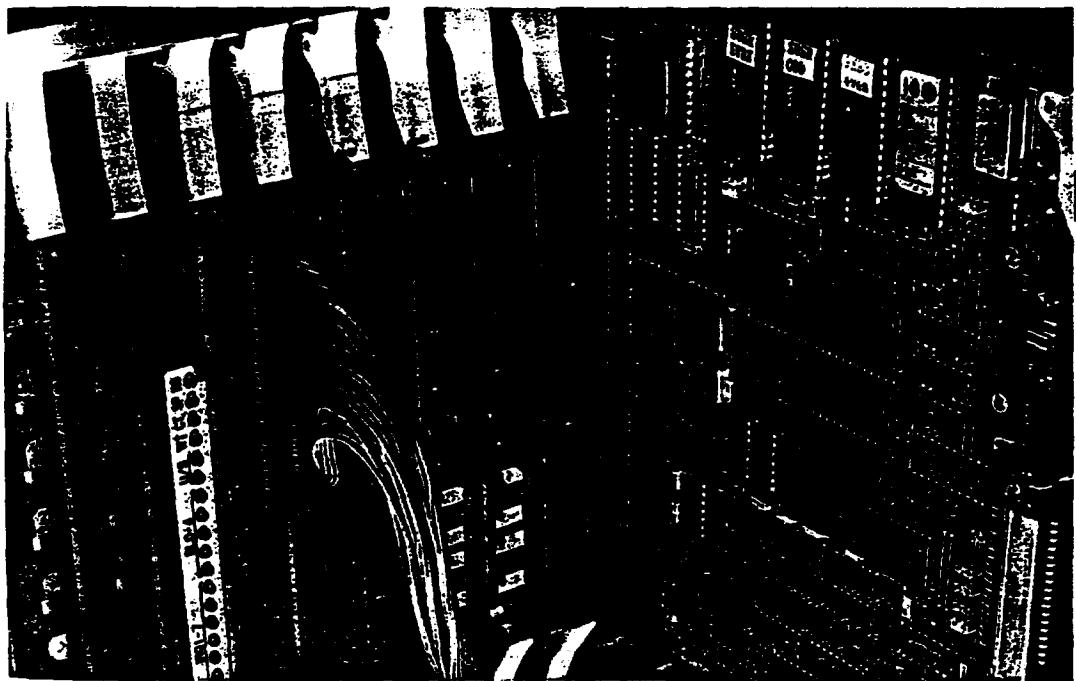
### Engineering

During a century of operations in the tobacco business, Japan Tobacco has accumulated extensive know-how in the design and manufacture of machinery used in the tobacco production process. Our technical expertise in quality processing and control, for example, provides a platform from which the Company can venture into new business areas. At our Engineering Research Laboratory, six R&D teams work with such advanced equipment as infrared analyzers, expert systems, and CAD systems to research laboratory automation, factory automation, inorganic materials,

organic materials, information systems, and sensors.

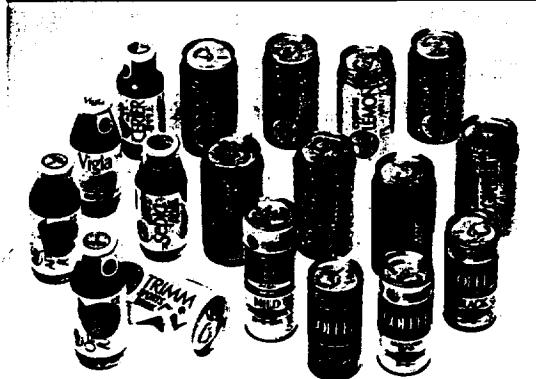
This strong background in machinery technology enables us to offer our clients a diversity of engineering products and services ranging from sensors and high-speed precision machines for other industries to systems engineering for factory automation and laboratory automation, and to design and engineering services for plant construction.

In 1987, we established JT Engineering Inc. (JTE) to provide comprehensive engineering services. JTE assists us in domestic and overseas sales of tobacco product manufacturing equipment and in designing improvements in production at new plants. JTE's operations also include basic equipment design and consulting services. Although the bulk of its business is related to machinery for automated cigarette packaging, JTE also has experience in more than 12 other industries. We expect JTE's expertise in comprehensive engineering services to aid in its expansion not only in the domestic market but in such overseas markets as the Middle East and Southeast Asia.

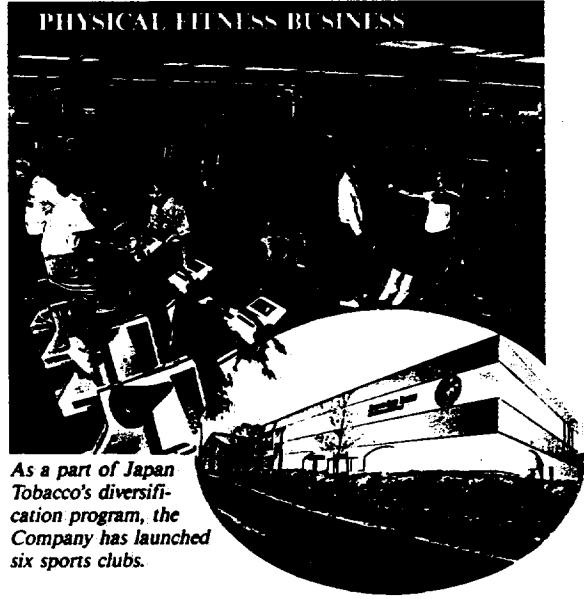


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*The Company's engineering services, based on its leading worldwide tobacco production technology, are being actively applied in the tobacco industry and a wide diversity of other business sectors.*

**BEVERAGES**

*The HalfTime brand includes 23 different types of beverages. Nine of these feature herb additives to enhance the flavor.*

**PHYSICAL FITNESS BUSINESS**

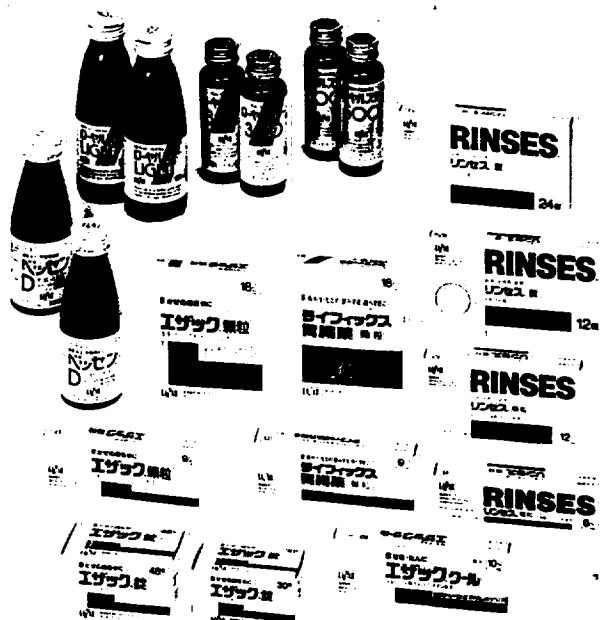
*As a part of Japan Tobacco's diversification program, the Company has launched six sports clubs.*

**SALT PRODUCTION**

*Easy-to-use packaging is an important feature of these salt products sold for home use.*

**TOBACCO PRODUCTS**

*Japan Tobacco's 103 tobacco brands meet a wide range of smoking tastes. At present, five brands are manufactured under licensing agreements.*

**PHARMACEUTICALS AND HEALTH DRINKS**

*Introducing various products marketed and developed by Lifix: 12 over-the-counter preparations for treatment of colds, stomach disorders, a medicinal drink, and 3 kinds of health drinks.*

# NOTES TO NON-CONSOLIDATED FINANCIAL STATEMENTS

Japan Tobacco Inc.  
Years ended March 31, 1988 and 1989

## 1. Organization and business

Japan Tobacco Inc. (the Company) was incorporated on April 1, 1985 as an ordinary business company, pursuant to the Nihon Tabako Sangyo Kabushiki Kaisha Law (the Law) enacted upon the resolution of the Japanese Diet.

Japan Tobacco and Salt Public Corporation (the Public Corporation), the predecessor of the Company, which had conducted tobacco and salt operations, was dissolved on the date of the Company's incorporation.

Upon incorporation, the Company, with the assets and liabilities of the Public Corporation, began the same operations as the Public Corporation, and is expanding its business in accordance with the diversification program connected with agribusiness, pharmaceuticals, engineering and real estate with the approval of the Japanese government. However, as the Monopoly in Salt Act (the Monopoly Act) is still effective, the salt operations, which are conducted in order to provide the nation with salt at a reasonable price and strengthen the foundations of the domestic salt industry, are regarded as a designation from the Government. Accordingly, the salt operations are not subject to the shareholder's rights and are basically exempt from income taxes.

As a result, the Company's assets and liabilities and the results of its operations should be separately accounted for between the profit-oriented operations represented by the tobacco business, and the salt operations.

Pursuant to the Law, the Government should keep more than one-half of the shares of the Company (two-thirds of the shares for the provisional term by the supplementary provisions of the Law); at present, all of the shares are held by the Government.

Considering the circumstances surrounding the Company described above, the Law and the Monopoly Act require that approval and authorization be obtained from the Minister of Finance regarding fundamentals such as: (1) the issuance of new shares and convertible debentures, (2) amendments to the Articles of Incorporation, (3) operating plan and (4) appropriations of earnings for the profit-oriented operations, and for the salt

operations: (1) operations plans, (2) budget, (3) plan of cash position, (4) borrowing of long-term loans and (5) financial statements.

## 2. Basis of presenting financial statements

The non-consolidated financial statements have been prepared in accordance with the provisions set forth in the Japanese Commercial Code and the related accounting regulations and the Monopoly Act, and in conformity with generally accepted accounting principles and practices in Japan. Under the Japanese Commercial Code, the Company is not required to prepare consolidated financial statements.

In preparing the non-consolidated financial statements, certain reclassifications and rearrangements have been made in the financial statements issued domestically in Japan in order to present these statements in a form which is more familiar to readers outside Japan. In addition, certain note information which is not required under generally accepted accounting principles and practices in Japan is presented herein as additional information.

## 3. Summary of significant accounting policies

### a) Securities

Quoted marketable and investment securities are stated at the lower of cost or market, cost being determined on the moving average method. Other securities are stated at the moving average method.

### b) Inventories

#### Profit-oriented operations:

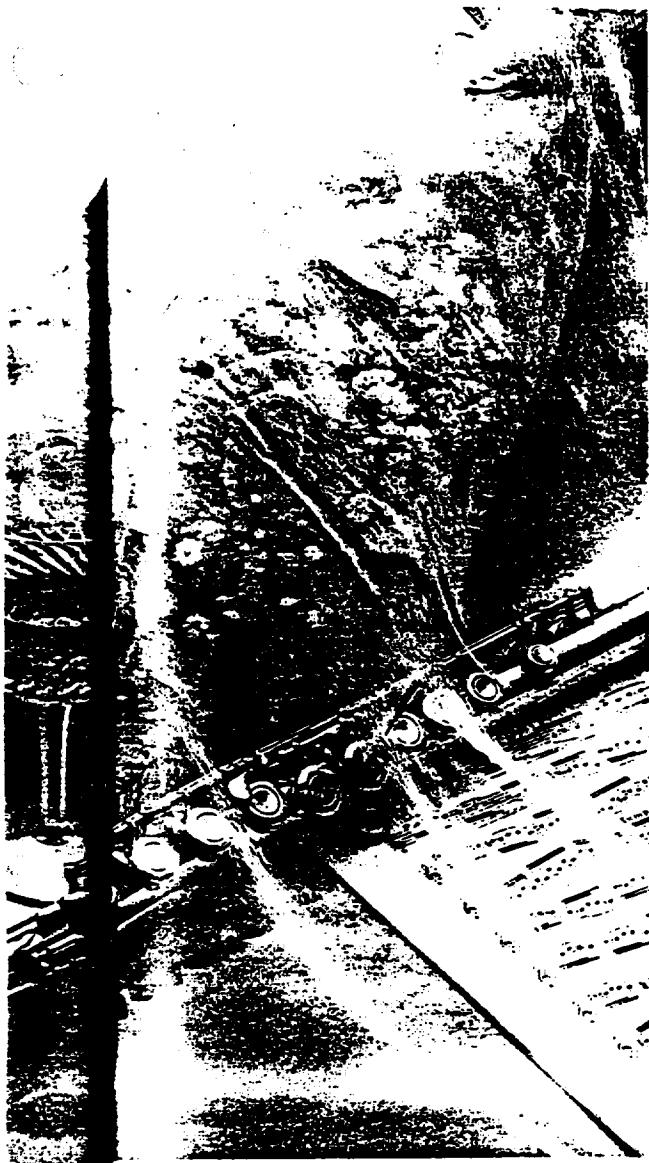
Inventories mainly consisting of leaf tobacco are stated substantially at the average method.

In accordance with generally recognized practices, leaf tobacco is classified as current assets, although part of such inventories, due to the duration of the aging process, ordinarily will not be sold within one year.

#### Salt operations:

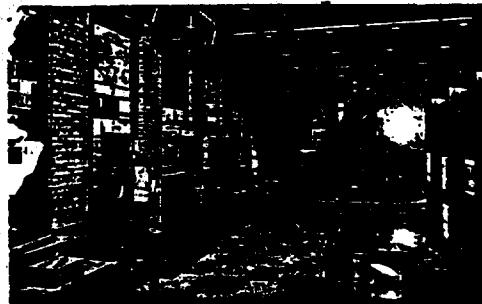
Inventories in salt operations are stated at the average method.

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sponsorship for concerts and other artistic activities as well as endowments for the training of performing artists. This foundation is one of the largest devoted to the musical arts in Japan.

In addition, Japan Tobacco is active in sponsoring various cultural and sports programs, including jazz festivals, motor races, a World Cup for sailing, classical music concerts, and monthly talk shows.



*Our Tobacco and Salt Museum, a unique museum incorporating the history and culture of the salt and tobacco industries, is widely known and highly regarded in Japan.*



*At the Company's "Salt Experimental Classroom," which is held in major cities throughout Japan every summer, children experience the "mystery and fun" of salt.*

public aware of the fire hazards associated with careless smoking. From early on, we installed ashtray stands in parks and other public facilities and gave away free portable ashtrays to prevent smokers from littering streets with cigarette butts. More recently, we have begun to emphasize such smoking etiquette as showing greater consideration for non-smokers.

In 1988, we established the AFFINIS ARTS FOUNDATION, our most ambitious plan so far to promote activities in the field of music. The objectives of this foundation include providing



*Japan Tobacco has promoted its "Smokin' Clean" campaign for over 20 years. As a member of the corporate community, we will continue promoting courtesy among the smoking public.*

# OUR PRODUCT LINEUP



## AGRICULTURE AND GARDENING SUPPLIES



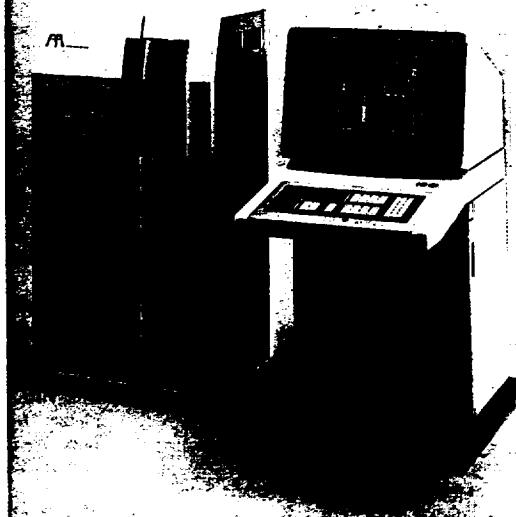
The development of these gardening supplies, various food products, and other agricultural products is made possible through Japan Tobacco's extensive experience in agribusiness.

## VENDING MACHINES



Vending machines attractively display Japan Tobacco's cigarettes and soft drinks. Sixteen types of these machines are in use for cigarette sales.

## MACHINERY AND SYSTEMS



This sophisticated digital intelligent control system developed by Japan Tobacco is one example of the Company's capabilities to provide a wide range of equipment from tobacco manufacturing machinery to general-purpose manufacturing and control systems.

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#### **10. Amounts per share relating to the profit-oriented operations**

Amounts of net income and net assets per share, relating to the profit-oriented operations, are computed based on the weighted average number of shares of common stock outstanding during each year and on the number of outstanding shares of common stock at each balance sheet date, respectively. The information referred to above follows:

Years ended March 31,	Yen		U.S. dollars
	1988	1989	
Net income per share	¥ 13,803	¥ 15,633	\$ 118
At March 31,	1988	1989	1989
Net assets per share	¥455,405	¥467,004	\$3,538

To compute the above figures, the net income and net assets relating to the salt operations have been excluded, owing to their not being subject to the shareholder's rights as described in Note 1.

#### **11. Compensation to farmers**

As a result of having ceased renewing contracts with farmers who had been contracted on a long-term basis, the Company paid ¥19,613 million (\$148 million) in 1989 as compensation.

The payments were included in "Other income (expenses)—Other, net" in the 1989 statements of income.

#### **12. Commitments and contingencies**

The Company is required to purchase all of the leaf tobacco produced, under the terms of the annual contract entered into with tobacco farmers, as stipulated in the Tobacco Business Code with regard to the method of purchasing the domestic crop. The purchase amount for the coming year is to be determined when the contracts are entered into with farmers, based upon the conclusions to be made by the Leaf Tobacco Council around September 1989.

The Company contracts various kinds of lease agreements. Annual rental expenses, primarily office premises, automobiles and computer equipment, came to ¥12,440 million and ¥19,230 million (\$146 million) for the years ended March 31, 1988 and 1989, respectively.

At March 31, 1989, the Company had no material litigations or claims outstanding, pending or threatened against it.

#### **13. Subsequent event**

The following plan for the appropriations of retained earnings for the year ended March 31, 1989 was approved at the shareholder's meeting held on June 28, 1989.

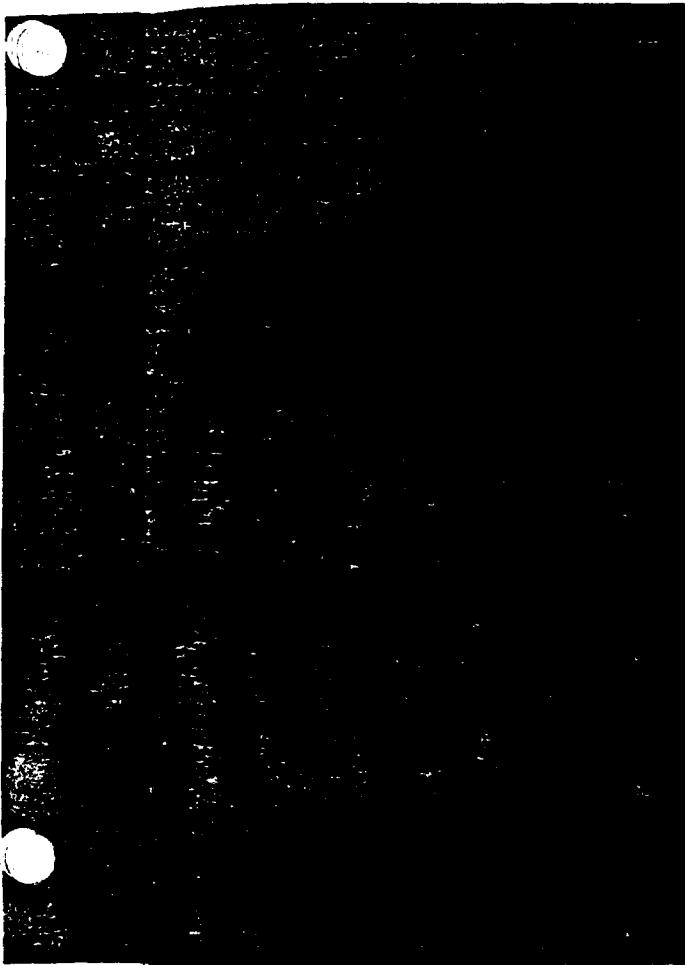
	Millions of yen	Millions of U.S. dollars
Cash dividends, ¥5,000 (\$38) per share	¥10,000	\$76
Transfer to legal reserve	1,000	7
Bonuses to directors and statutory auditors	71	1
<b>¥11,071</b>	<b>\$_84</b>	

#### **14. Profit-oriented operations**

Under the Commercial Code and related accounting regulations, the Company is required to disclose the financial information of the profit-oriented operations together with the Company's financial statements which include the salt operations.

The financial information of the profit-oriented operations for 1988 and 1989 is shown on the following pages through page 34.

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*Nuclear granules and chromosomes (HeLa cell mitotic phase). In analyzing carcinogenesis and cell differentiation mechanisms, the study of cellular and protein structures is very important. We are aiming to understand the functions of protein structures in these two fields.*

proteins. In studying insect pheromones, LSRL is attempting to understand how male insects locate female insects through the detection of airborne pheromones, a chemical secreted by female insects.

LSRL has two main objectives in these research activities. The first is to open the door to the technological development of life models, which will enable breakthroughs in each business area. This involves 1) the development of fine chemicals through studies of controls for genetic discoveries and the development of revolutionary catalysts; both of these activities are based on the discoveries of basic, technological breakthroughs concerning life recognition mechanisms; and 2) the application of sensory and recognition research to advanced artificial intelligence robots.

The second main objective of LSRL is to develop potential future business avenues that will sustain our growth into the 21st century and beyond.

#### **Life Science Research Laboratory**

LSRL was established to research the recognition and response abilities of life forms using three paradigms: plant viruses, animal cells and proteins, and insect pheromones. In studying plant

viruses, LSRL has focused on RNA, a gene which has the ability to self-replicate. Through these efforts, researchers at LSRL have already succeeded in producing tobacco plants resistant to the cucumber mosaic virus (CMV) by inserting cDNA, a satellite RNA parasitic on CMV, into a tobacco nucleus.

In the area of animal cells and proteins, researchers are studying mechanisms of cell differentiation and carcinogenesis through genetic engineering and X-ray crystallography to understand more about the structure and function of



*Rotary evaporator: In search of increased quality, we are working to further expand the range of aromas and tastes, as well as the variety of our tobacco products by researching the natural aromatic particles and physiological activators present in leaf tobacco.*

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**c) Property, plant and equipment**

Property, plant and equipment are carried at cost. Depreciation is computed on the declining-balance method over the estimated useful lives of assets stipulated by the Japanese Corporate Tax Law. The useful lives of major assets are substantially 50 years for buildings and 8 years for tobacco producing machinery.

**d) Investments in subsidiaries and associated companies**

Investments in subsidiaries and associated companies (ownership: 20% to 50%) are stated at cost.

**e) Income taxes**

Income taxes are provided for amounts currently payable for each year. Deferred income taxes pertaining to timing differences in the recognition of certain income and expenses between financial and tax reporting are not recognized.

**f) Retirement benefits**

Under most circumstances, employees of the Company terminating their employment are entitled to lump-sum payments based on the rate of pay at the time of termination, years of service and certain other factors. The Company provides for retirement benefits to state the amount which would be required if all employees voluntarily terminated their employment at each balance sheet date. Provisions for retirement benefits include those for directors and statutory auditors of the Company. Such provisions are not funded.

**g) Research and development expenses**

Research and development expenses are charged to income as incurred.

**h) U.S. dollar amounts**

Amounts in U.S. dollars are included solely for the convenience of readers. The rate of Y132=U.S.\$1, the approximate rate of exchange at March 31, 1989, has been used. The inclusion of such amounts is not

intended to imply that Japanese yen have been, could have been, or could be readily converted, realized or settled in U.S. dollars at that or any other rate.

**4. Accounting change**

Effective April 1, 1988, in order to meet the declining tendency of the purchase price, the Company changed its method of valuing leaf tobacco from the last-in, first-out method to the average method. This change had the effect of reducing inventories and income before income taxes by Y20,936 million (\$159 million).

**5. Transactions with subsidiaries**

The transactions with and due from/(to) subsidiaries were as follows:

**Transactions:**

	Millions of U.S. dollars		
	1988	1989	1989
Sales	Y 4,768	Y 10,750	\$ 81
Purchases	42,769	101,262	767
<b>Due from/(to):</b>			
Receivables	Y 7,435	Y 6,816	\$ 52
Payables	(5,717)	(13,846)	(105)

**6. Inventories**

Inventories at March 31, 1988 and 1989 comprise the following:

	Millions of U.S. dollars		
	1988	1989	1989
<b>Profit-oriented operations:</b>			
Leaf tobacco	Y777,200	Y704,728	\$5,339
Finished products	52,436	44,401	337
Other	20,955	17,043	129
	850,591	766,172	5,805
<b>Salt operations:</b>	3,557	3,063	23
<b>Total</b>	<u>Y854,148</u>	<u>Y769,235</u>	<u>\$5,828</u>

other agricultural products that can be used safely and inexpensively. In addition, we have looked to team up with appropriate partners in Japan and overseas to deepen our knowledge in these areas and broaden the potential applications. Especially through tie-ups with the world-renowned biotechnology companies Plant Genetics Systems and Myco-gen, we are endeavoring to develop new plant products and bioherbicides.

In foods, Japan Tobacco is aiming to establish a sound business foundation through offering products with superior nutritional value and taste and by targeting certain parts of the market. Examples include a subsidiary engaged in the mushroom business, Fuji BioFarm Corp., and another in the noodle and processed meat business, JT Agris Corp. These two companies offer specialized foods of distinctive quality. In addition, we established Chicago Foods Corp. in a joint venture with another company in July 1988. In July 1989, we opened our first gourmet hot dog restaurant in Roppongi, Tokyo, an area popular with young people, in our first step into the restaurant business. In addition, to develop various foods businesses that contribute to the establishment of a better diet, we are promoting research in ingredients, processing methods, and recipes at our Food R&D Center while tracking and analyzing prevailing food trends.

#### Beverages

In beverages, our engineers have used technology accumulated through many years of tobacco production to develop the HalfTime line of canned drinks, which offers our customers a variety of flavors and a distinctly delicate taste. Our knowledge of blending and aromas enabled us to produce aromatic essences closely resembling natural aromas and to use them to flavor beverages. In view of the potential growth the beverage industry has in Japan, we first targeted the canned beverage market, specifically beverages sold in vending machines, as the market with the highest growth potential.

Since our HalfTime product line of canned beverages was released in April 1988, consumer response has exceeded our original expectations. In addition to three prefectures and the Tokyo metropolitan area, we have expanded our sales area to include four prefectures surrounding Nagoya from February 1989. From June 1989, HalfTime will be sold throughout Japan in convenience stores.

Contributing factors to the popularity of Japan Tobacco's HalfTime product line have been its controlled sweetness aimed at the adult taste preference, its unified container and vending machine design, and the Company's already established strong network of vending machine locations. By making the can design uniform



We offer decorative greenery to beautify the urban home. Customer response has been very favorable for our simple garden sets and a variety of other decorative greenery products.

with that of the vending machine, we are aiming to raise public awareness of HalfTime and set it apart from ordinary canned beverage products. In addition, the strategic placement of HalfTime vending machines next to our tobacco vending machines increases product exposure while facilitating customer access.

## CORPORATE DATA

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**Date of Establishment**  
 April 1, 1985

**Paid-in Capital**  
 ¥100 billion

**Number of Employees**  
 26,700

**Offices & Factories**

Regional Sales Headquarters .....	3
Area Sales Headquarters.....	14
Sales Offices .....	257
Regional Leaf Tobacco Headquarters .....	8
Regional Leaf Tobacco Offices .....	1
Leaf Tobacco Offices .....	70

Cigarette Manufacturing Factories..... 32  
 Processing Factories and Another Factory ..... 11

Machine Factories ..... 2  
 Printing Factory ..... 1

Salt Industry Centers ..... 11  
 Salt Industry Offices..... 11

Support Service Centers..... 6  
 Hospitals ..... 2

**Laboratories**  
 Applied Plant Research Laboratory  
 Leaf Tobacco Research Laboratory  
 Tobacco Science Research Laboratory  
 Pharmaceutical Research Laboratories  
 Food R&D Center  
 Life Science Research Laboratory  
 Sea Water Science Research Laboratory  
 Plant Breeding and Genetics Research Laboratory  
 Engineering Research Laboratory  
 Toxicology Research Laboratories  
 Product R&D Center

(As of April 1, 1989)

## OVERSEAS OFFICES

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 Fax: 919-833-6208

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 Fax: 2-236-9123

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 Fax: 51-215-156

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 Fax: 852-3-739-8709

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## BRANCHING OUT



*At the Company's pharmaceutical laboratories, a wide range of innovative research in synthetics, biochemistry, and drug formulations is paving the way for the development of new pharmaceutical products.*

Japan Tobacco's diversification program is a natural expansion springing from its roots in the tobacco industry and from its accumulated resources, such as R&D technological capabilities and real estate. For example, we have established sports clubs by utilizing our real estate resources. In addition, our sales distribution network, incorporating more than 270,000 stores nationwide, provides other opportunities for diversification. At present, while their contributions to total turnover are still minor relative to those from our established tobacco business, we are confident that these new businesses will grow to become additional areas of income support. On the following pages, we will present a short introduction to our business in the pharmaceutical, agribusiness, beverages, and engineering sectors, which represent our main new areas of operations.

### Pharmaceuticals

In pharmaceuticals, we have already developed and manufactured a wide range of health-related products in OTC drugs so that people may enjoy healthier and higher-quality lifestyles. At present, our scientists at the Pharmaceutical Research Laboratories and the Toxicology Research Laboratories—where research in pharmacochemistry, biochemistry, pharmacology, pharmaceutical

development, and toxicology is being conducted—are in the process of developing sophisticated and advanced technologies and biotechnologies.

In prescription drugs, research activities involve the development of medicines to treat diseases of the central nervous system, the cardiovascular system, and cancer as the number of older people increases. The Company is aiming to apply the results of these research activities to marketable products as soon as possible through joint research work with various research organizations and pharmaceutical companies in Japan and overseas. In general, long years of research and substantial R&D investments are necessary to develop a new drug. Recently, 10 to 16 years and between ¥8 and ¥10 billion have become the norm for a drug to be developed and marketed. For this reason,



*Lifix is aiming for future growth by taking full advantage of Japan Tobacco's extensive sales and distribution network and marketing know-how.*

it is necessary to have a long-term plan and patience during the research, manufacture, and distribution phases to expand our pharmaceutical business. At present, we are continuing to strengthen our R&D staff, building from the current 130 scientists to reach a total of 400 at the earliest date possible. In two or three years, we are also planning to construct two R&D laboratories. In addition, a pharmaceutical agent is already in the second phase of clinical study, and we are in the process of establishing a manufacturing and sales structure for

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## 15. Salt operations

The salt operations started with the capital fund of salt monopoly business of ¥25,683 million (\$195 million) and the reserve for salt monopoly price stabilization of ¥11,298 million (\$86 million). Under the provisions of the Monopoly Act, the results of operations are credited to the reserve for salt monopoly price stabilization and the reserve may be used only to offset the losses from the salt operations.

Summarized financial information of the salt operations included in the financial statements follows:

	Millions of U.S. dollars		
	1988	1989	1989
At March 31,			
Current assets	¥53,241	¥61,514	\$466
Other assets	18,033	18,277	139
	¥71,274	¥79,791	\$605
Current liabilities	¥ 2,793	¥ 2,973	\$ 23
Other liabilities	3,108	4,385	33
	5,901	7,358	56
Capital fund of salt monopoly business	25,683	25,683	195
Reserve for monopoly price stabilization	39,690	46,750	354
	65,373	72,433	549
	¥71,274	¥79,791	\$605
Years ended March 31,	1988	1989	1989
Revenues	¥70,705	¥69,537	\$530
Costs and expenses	63,549	65,438	496
Other income, net	2,146	2,646	20
Income taxes	19	85	1
Net income	¥ 9,283	¥ 7,060	\$ 53

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To the Board of Directors  
Japan Tobacco Inc.

We have examined the non-consolidated balance sheets of Japan Tobacco Inc. as of March 31, 1988 and 1989 and the related non-consolidated statements of income and shareholder's equity for the years then ended, all expressed in Japanese yen. Our examinations were made in accordance with generally accepted auditing standards in Japan and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the non-consolidated financial statements referred to above present fairly the financial position of Japan Tobacco Inc. as of March 31, 1988 and 1989 and results of its operations for the years then ended, in conformity with applicable laws and generally accepted accounting principles in Japan consistently applied during the period except for the change made in 1989, with which we concur, in the method of valuing inventories as described in Note 4 of the notes to non-consolidated financial statements.

The United States dollar amounts shown in the accompanying non-consolidated financial statements have been presented solely for convenience. We have reviewed this translation and, in our opinion, the non-consolidated financial statements expressed in Japanese yen have been translated into United States dollars on the basis described in Note 3 to the non-consolidated financial statements.

 Tohmatsu Awoki  
& Sanwa

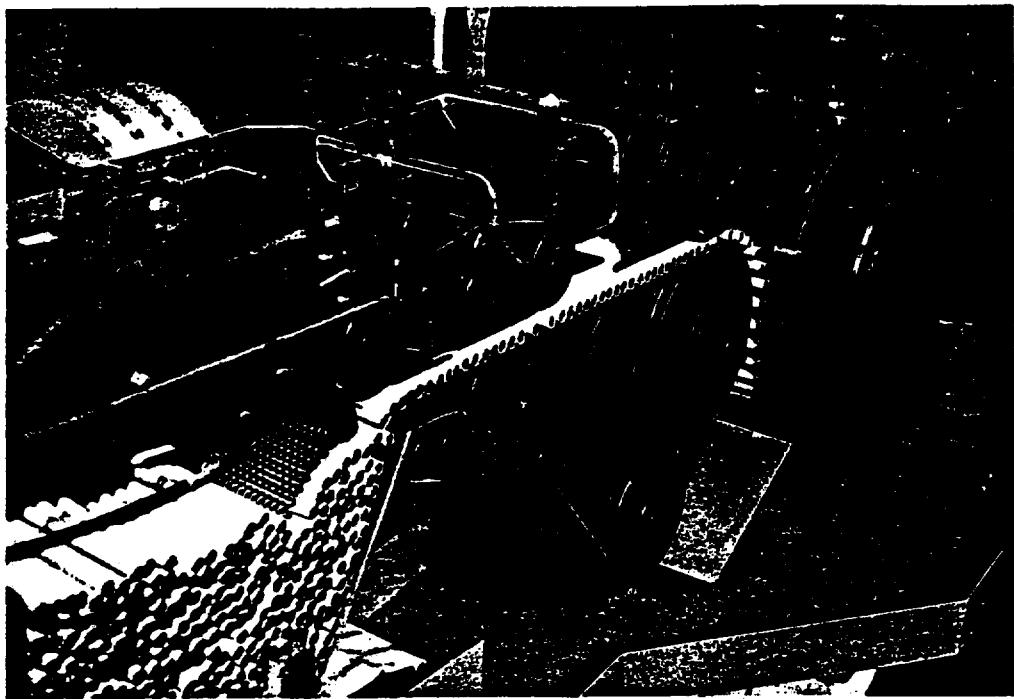
*Tohmatsu Awoki & Sanwa*

May 15, 1989  
(June 28, 1989 with respect to Note 13)

Touche Ross International

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The MMDP-8000, developed by the Company, is one of the world's fastest cigarette making machines, capable of producing 8,000 cigarettes a minute.



industry, and improving management efficiency through the usage of computers. While aiming for optimal usage of available personnel, the introduction of the MMDP-8000, one of the world's fastest cigarette making machines developed by Japan Tobacco, will allow the Company to save further on labor costs while increasing product quality. In addition to new large-scale computer network systems linking our plants and offices throughout Japan, an expert system helps us to avoid system crashes for the MMDP-8000.

Further efforts to raise efficiency have

business. In future years, we anticipate that our products will remain favored by the Japanese public, aided by dynamic contributions from our subsidiaries, JT Distribution, Japan Tobacco Aimex (leaf tobacco imports), JT Soft Service, and Japan Tobacco International (JATICO).

JATICO was established in 1984 to handle our international tobacco business. Since the establishment of JATICO, the growth of our international business has been phenomenal. In fiscal 1988, the volume of exports to more than 30 countries increased 82.0%

enabled us to trim inventory levels from the typical one month in 1985 to an average of 0.3 months at present, translating into substantial cost savings.

We are also continuing to improve and reorganize our operational structure to better serve the needs of major cities and urban areas in Japan. As the leading tobacco company in Japan, we are striving to meet the needs of all our customers by keeping a sharp eye on shifting market demands.

Through these measures, we are aiming to turn over a new leaf in our tobacco



Japan Tobacco is continuously introducing the latest, most sophisticated technology into its operations. Through such equipment as advanced computers, we are aiming to further automate the production process and raise the efficiency and speed of production machinery.